Government Executive

Not Exactly Getting Rich

By Tammy Flanagan

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Last week, I took a fresh look at the Windfall Elimination Provision, which affects the Social Security benefits calculation for those covered under the Civil Service Retirement System, because they did not have Social Security taxes withheld from their salaries. According to the Congressional Budget Office, as of this year, about 1.4 million CSRS retirees may be affected by this provision if they also qualify for their own Social Security retirement benefit.

Last week's column led to lots of reader comments, like this one:

I know this is heresy to my fellow feds, but I believe that Congress essentially got things right when they established the WEP provision in 1983. Given the formula for computing Social Security benefits and its bias towards (apparent) low wage earning individuals, federal employees in those CSRS coverage, pre-Federal Employees Retirement System days indeed were being given unfair preferential treatment prior to the WEP's enactment in the computation of any Social Security benefit they might have claimed based on periods of non-federal employment.

I both agree and disagree with this statement. Social Security indeed was designed as a kind of insurance program, and is intentionally tilted to favor lower wage earners. Like other forms of insurance, it requires a lot of people to pay into it so that those who are most in need can reap the benefits. According to the Social Security Administration, lower-paid workers who have worked in careers covered by Social Security could get a benefit that equals about 55 percent of their pre-retirement earnings. The average replacement rate for highly paid workers is about 25 percent.

To see exactly how this works for federal employees, let's compare two examples: one involving a federal employee who works his entire career under either CSRS or FERS, and another who has split her career between federal employment and private sector work covered by Social Security.

Forty Years Under CSRS

An employee under CSRS who has 40 years of government service would be entitled to a benefit worth 76.25 percent of their high-three average salary, regardless of being a low or a high wage earner.

Forty Years Under FERS

An employee covered under FERS from age 22 to 62 can achieve nearly the same income replacement as her CSRS counterpart. The FERS basic retirement benefit would provide 44 percent of her high-three average salary. If she claims her Social Security benefit at 62, she would receive a benefit 25 percent less than she could get by waiting to claim Social Security until her full retirement age (currently 66). The reduced Social Security benefit received at 62 will replace another 30 percent of income for an employee earning around $50,000 in her last year of employment. Between her FERS retirement and Social Security, she would have a replacement of 74.4 percent of her pre-retirement income.

For an average wage earner, FERS provides a comparable outcome of replacement income to CSRS even without considering the additional income that could be generated from investments in the Thrift Savings Plan. For higher wage earners, the Social Security benefit would replace a little less than 30 percent of pre-retirement income. In this case, the employee would be able to make up the difference from her TSP investments, or could work longer to increase the percentage of replacement income from FERS and Social Security.

Twenty Years Under CSRS, Then Twenty Covered By Social Security

The problem for some federal employees is that they don't spend their entire career working for one employer. For an employee whose work history is split between CSRS and employment covered by Social Security, the effect of the WEP can produce an unfortunate problem.

Suppose Sally worked 20 years under CSRS, and another 20 at a job where she paid Social Security taxes. The federal work would provide a deferred retirement benefit that would replace 36.25 percent of her high-three average salary. Her Social Security benefit would be computed by adjusting the 20 years of Social Security-covered wages to bring them up to wage values for the year Sally turns 62, and then averaged over 35 years.

So, using a wage of $50,000, her benefit would be computed by adding up the 20 years of Social Security covered employment ($50,0000 x 20 = $1,000,000) and then dividing the total wage by 420 months (35 years x 12), or $2,380 for her average monthly wage. The last step is to apply the Social Security benefit formula to determine her monthly benefit amount:

90% x 826 = $743.40

+

<u>32% x $1,554 = $497.28</u>

$1240.68

That benefit would be payable at age 66, so if she claims it 62, it will be reduced by 25 percent, to $930.51, or $11,166 per year.

But Sally wouldn't be entitled to that amount, because the WEP requires that the first factor in the calculation (90 percent) be changed to 40 percent, because of Sally's CSRS benefit. (She would be exempt from the WEP if she had at least 30 years of substantial employment covered by Social Security.) The benefit is further reduced by 25 percent if she claims it at age 62.

So Sally's benefit would be computed as follows:

40% x 826 = $330.40

+

<u>32% x $1,554 = $497.28</u>

$827.68

The other problem is that if Sally left federal service 20 years before age 62, her deferred retirement would have been based on her high-three average salary when she left federal service. This would have been much lower wages (say $20,000), not her current salary of $50,000. Her CSRS benefit would be computed as 36.25 percent of $20,000 or $7,250 / year. So her total replacement income at age 62 would be $7,449 + $7,250, or $14,699. That's only a 29 percent replacement of her pre-retirement income, far short of the 76.25 percent replacement she would have had if she had remained under CSRS for her entire career. If she spent her Social Security-covered years under FERS, this would have provided an additional FERS retirement benefit of 22 percent of her high-three salary, and she would be back to a replacement that is closer to what she needs to be able to retire.

The WEP cut Sally's Social Security benefit by around $5,000 a year, which would have gone a long way to helping her make up the income she will need to retire comfortably. Most would not consider that Sally is getting anything close to a windfall.

I'll be conducting a webinar with certified financial planner Karen Schaeffer, next Thursday, May 14, on the topic of survivor *benefit elections at retirement. This should be an interesting discussion of how the survivor benefit works under CSRS and FERS, comparing it to other options to protect the loss of your retirement income if you die before your spouse in retirement. You can register for the webinar at www.nitpinc.com.*

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